No. 174

In the Supreme Court of the United States

OCTOBER TERM, 1958

UNITED STATES OF AMERICA, PETITIONER

v.

EMBASSY RESTAURANT, INC., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES

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OPINIONS BELOW

The opinion of the District Court (R. 34–36) is reported at 154 F. Supp. 141. The opinion of the Court of Appeals (R. 42–47) is reported at 254 F. 2d 475.

JURISDICTION

The judgment of the Court of Appeals was entered on April 16, 1958. (R. 47–48.) The petition for a writ of certiorari was filed on July 15, 1958, and was granted on October 13, 1958. (R. 48.) The jurisdiction of this Court is conferred by 28 U. S. C., Section 1254 (1) and Section 64 of the Bankruptcy Act, as amended.

QUESTION PRESENTED

Whether contributions required to be made by an employer to a union welfare fund, pursuant to the terms of a collective bargaining agreement, are entitled, in bankruptcy, to priority over federal taxes owed by the employer, on the theory that the contributions constitute "wages * * * due to workmen" within the meaning of Section 64a (2) of the Bankruptcy Act, as amended.

STATUTE INVOLVED

Bankruptcy Act, c. 541, 30 Stat. 544:

> SEC. 64 [As amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840]. *Debts Which Have Priority.*—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; * * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof * * *.
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> * * * * * *

(11 U. S. C. 1952 ed., Sec. 104.)

STATEMENT

The facts are undisputed, and may be stated as follows:

On March 21, 1951, Embassy Restaurant, Inc., the bankrupt employer, entered into a collective bargaining agreement with the Local Joint Executive Board of Philadelphia (referred to in the contract and herein as the "Union"), consisting, *inter alia,* of Local Unions Nos. 111 and 301. In that agreement (see R. 4–6) the employer recognized the Union as the sole and exclusive bargaining representative of its employees (R. 5). The agreement contained provisions relating to hours, wages, vacations, holidays, seniority and other conditions of employment. (R. 5–6, 34.) Another provision related to sick leave with pay. (R. 34.)

This bargaining agreement was subsequently amended by supplemental agreements (see R. 6–7) which were substantially alike except that they applied to the employee-members of different local unions. Under each of these amendments the sick leave benefits provided by the bargaining agreement for the members of Local Unions 111 and 301 became ineffective upon the adoption of a Welfare Plan for the particular union (effective September 1, 1951) pursuant to which the employer, Embassy Restaurant, Inc., agreed to make contributions to a Welfare Trust Fund for that local union.

Subsequently, on July 1, 1956, another collective bargaining agreement (R. 27–31) was executed between the Union (consisting, *inter alia,* of Local Unions 111 and 301) and the Greater Philadelphia Restaurant Operators, Inc., acting on behalf of Embassy Restaurant, Inc., and other restaurants. Under this bargaining agreement, which was the one in effect

when Embassy Restaurant, Inc., was adjudged a bankrupt (R. 34), each employer agreed to pay $8 a month to the Welfare Trust Funds of Local Unions 111 and 301 for each full-time employee member of those local unions (R. 29–30). The agreement stated, among other things, that the trust funds "shall be maintained and utilized to promote Life Insurance, Weekly Sick Benefits, Hospital and Surgical Benefits and other benefits for the employees who are members of Locals 111 * * * and 301 in the employ of the Employer, as in past practice." (R. 30.) Although the agreement contained provisions relating to Sick Leave, it was expressly agreed that those provisions were to be operative only in the event that the Welfare Plans provided in the agreement were not in effect. (R. 29.)

The Welfare Plans for Local Unions 111 and 301 were administered pursuant to formal written agreement and declaration of trust. (R. 34.) Under each trust agreement (see, for example, R. 9–24), the Welfare Plan for the particular union was administered and operated by a Board of Trustees composed of three persons designated by the Executive Board of the Union (R. 11–12), who were authorized to formulate and establish the conditions of eligibility for welfare benefits and, among other things, to control the funds of the Welfare Plan, to require and collect all employer contributions due the Welfare Plan and, in their sole discretion, to maintain any and all actions for legal proceedings necessary for the collection of the employer contributions and file claims in any proceeding in which an insolvent employer was involved (R. 13–15, 20–21). Title to all money, prop-

erty and income paid to or acquired by the Welfare Plan was vested exclusively in the Board of Trustees and no employee or any person claiming by or through any employee had any right, title or interest in the Welfare Plan or any part thereof. (R. 21–22.)

Subsequent to the employer's being adjudged a bankrupt, the trustees of the Welfare Funds of Local Unions 111 and 301 filed proofs of claim. In so doing, they asserted status as priority wage claimants, pursuant to the provisions of Section 64a (2) of the Bankruptcy Act, c. 541, 30 Stat. 544, as amended, for payments to the Welfare Funds of the amounts of $216 and $336, respectively, which had accrued in the three-month period prior to the bankruptcy. The Referee denied the claim of priority but allowed the trustees the status of general unsecured creditors. (R. 35.)

On review, the District Court vacated the order of the Referee and held that the claims of the trustees were priority claims for wages within the meaning of Section 64a of the Bankruptcy Act (R. 37), thereby giving them preference over the lien claim (R. 25–27) which had been filed by the Government for unpaid taxes. The Court of Appeals affirmed (R. 42–48).

SUMMARY OF ARGUMENT

The question in this case is whether trustees of a union welfare fund claiming against a bankrupt business enterprise may avail themselves of the priority accorded by Section 64a (2) of the Bankruptcy Act, as amended, to "wages * * * due to workmen," servants, clerks and salesmen. Contrary to the views of

the Second Circuit, whose position we support, the Third Circuit has answered this question affirmatively.

Any claim to priority over other claimants or creditors must have a clear statutory basis. *Nathanson* v. *Labor Board,* 344 U. S. 25, 29. Here, in our view, such a basis is lacking.

Fringe benefits in the form of payments made to a welfare or insurance fund are not wages in the accepted sense of that term. Moreover, the employer's obligation here is not one which runs to the employees or one which might be enforced by them; the unpaid contributions are not due the workmen but are owed to the trustees of the union welfare fund, albeit that fund is designed to provide ultimate benefits to the employees.

Apart from the fact that the statutory language does not provide adequate support for the trustees' claim, we believe that the trustees are seeking to attribute to Congress a purpose which goes well beyond its contemplation. The provision granting priority in bankruptcy to wages goes back over one hundred years to a period long antedating the negotiation of fringe benefits by labor unions. Such amendments as have been made over the years by Congress have been few and cautious ones: the ceiling on the priority wage claim has been raised (from $25 per claimant in 1841 to the present figure of $600); there have been some shifts in the relative priority position of wages due to workmen; and the protection originally given to workmen has been extended to salesmen. Throughout the history, there is discernible a single and limited purpose—to enable workmen displaced by an em-

ployer's bankruptcy to secure promptly the money directly due them in the form of back pay in mitigation of the hardship which may result from loss of employment. Contrary to the views of the court below, this does not encompass a purpose to grant priority to welfare funds which provide indirect and possibly remote benefits (*e. g.*, compensation for accidents or ill health) that may be wholly unrelated to the fact of an employer's bankruptcy.

In 1934, Congress, by separate and special provision, established a priority for a workman's claim against his employer arising out of a workmen's compensation award. In 1938, Congress eliminated this priority (though a claim for workmen's compensation was continued as a provable claim in bankruptcy). This indicates (a) that Congress does not regard all types of obligations owed by employers to employees as embraced within the concept of wages, and (b) that Congress does not believe that all claims having some connection with the employment relationship are equally entitled to preference.

In some jurisdictions, *e. g.*, the United Kingdom and the State of New York, which have long had provisions granting priority in bankruptcy to wage claims, priority has been granted (more recently) to claims against the employer for unpaid contributions to welfare and insurance funds. Significantly, this has been done by the process of statutory amendment and not by judicial interpretation. A bill along similar lines was recently before Congress but was not acted upon (though we note that such bill, even had it passed, would have covered only contributions—unlike

those here—based upon hours worked or wages paid).

This Court's decision in *United States* v. *Carter*, 353 U. S. 210, does not support the decision below. The issue there was whether trustees of a union welfare fund (a fund comparable to the one involved here) could sue on a Miller Act payment bond undertaking to guarantee laborers and materialmen all sums "justly due" them from a government contractor. The claim was allowed not on the theory that the unpaid contributions were wages, but, rather, on the grounds that the Miller Act has broad protective purposes and that the term "sums justly due" is not restricted to wages.

ARGUMENT

THE PRIORITY ACCORDED "WAGES * * * DUE TO WORKMEN" BY SECTION 64a (2) OF THE BANKRUPTCY ACT DOES NOT ENCOMPASS AN EMPLOYER'S UNPAID CONTRIBUTIONS TO A UNION WELFARE FUND REQUIRED TO BE MADE UNDER THE TERMS OF A COLLECTIVE BARGAINING AGREEMENT

This Court has declared that "The broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands * * *"; [1] that, in the execution of that purpose, Congress has established a "reasonable classification of claims as entitled to priority because of superior equities * * *"; [2] and that, if one claimant is to be preferred over others, this "purpose

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[1] *Kothe* v. *R. C. Taylor Trust*, 280 U. S. 224, 227; see, also, *Kuchner* v. *Irving Trust Co.*, 299 U. S. 445, 451, 452; *Sampsell* v. *Imperial Paper Corp.*, 313 U. S. 215, 219.

[2] *Carpenter* v. *Wabash Ry. Co.*, 309 U. S. 23, 28.

should be clear from the statute."[3] Here the question is whether unpaid employer contributions to a union welfare fund have priority over the Federal Government's claim for unpaid taxes. Despite the fact that other claims may not be preferred over the Federal Government's tax claim unless such a purpose is "clear from the statute," the court below accorded priority to the unpaid welfare fund contributions on the theory that those contributions may be "considered wages" (R. 45) and within the category of "wages * * * due to workmen" as that phrase is used in Section 64a (2) of the Bankruptcy Act, as amended (*supra*, p. 2). We believe this theory unsound, as the Second Circuit held in *Local 140 Security Fund* v. *Hack*, 242 F. 2d 375, certiorari denied, 355 U. S. 833, rehearing denied, October 13, 1958, 27 U. S. L. Week 3113.

Since the sense in which the phrase "wages * * * due to workmen" is used in the priority statute depends not only upon the language used but upon the purpose of the law as well, we turn first to a review of the legislative history of the relevant bankruptcy provisions.

A. TO TREAT UNPAID WELFARE FUND CONTRIBUTIONS AS "WAGES * * * DUE TO WORKMEN" WITHIN THE MEANING OF THE STATUTE IS NEITHER CONSONANT WITH THE CONGRESSIONAL USE OF THE WORD "WAGES" NOR WITH THE CONGRESSIONAL PURPOSE IN ACCORDING PRIORITY TO WAGES

The court below treated Section 64a (2) of the Bankruptcy Act as if it were general social legisla-

[3] *Nathanson* v. *Labor Board*, 344 U. S. 25, 29; *Sampsell* v. *Imperial Paper Corp.*, *supra*.

tion rather than a *priority* statute having the limited purpose of furnishing "distressed workers with a cushion of purchasing power against the impact of their employers' bankruptcy."[4] Certainly, there is nothing in the genesis of the statute to suggest that Congress proposed to deal with any phase of employer-employee relationships[5] other than the ordinary matter of workmen's collecting back pay owed personally and directly to them.

The development of this wage priority provision has been slow and cautious. In a period of over one hundred years, the changes have been few: enlargement of the amount of the preferred wage claim from $25 in 1841 to the present $600 limitation; occasional shifts in the position of relative priority; and expansion of the provision to include salesmen.

As pointed out by Collier in his work on Bankruptcy,[6] it was not until the Act of March 2, 1867, c. 176, 14 Stat. 517, that Congress evolved a comprehensive plan for permitting some classes of unsecured creditors to share in the assets of a bankrupt's estate

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[4] *In re Victory Apparel Manufacturing Corp.*, 154 F. Supp. 819, 822 (D. N. J.) (now pending on appeal to the Third Circuit); *In re Brassel*, 135 F. Supp. 827, 829 (N. D. N. Y.); *In the Matter of Sleep Products, Inc., Bankrupt*, 141 F. Supp. 463, 467 (S. D. N. Y.), affirmed *sub nom. Local 140 Security Fund* v. *Hack*, 242 F. 2d 375 (C. A. 2d), certiorari denied, 355 U. S. 833.

[5] *In the Matter of Sleep Products, Inc., Bankrupt*, *supra*, p. 468. See comment on this case in 66 Yale L. J. 449 (1956), where the author states (p. 460) that "[f]rom the standpoint of legislative intent" the *Sleep* opinion appears to be on solid ground.

[6] 3 Collier on Bankruptcy (14th ed., 1941), par. 64.01, pp. 2045–2053.

ahead of, or to the exclusion of, others. The pattern of priority there established governed the provisions of the Bankruptcy Act (Act of July 1, 1898, c. 541, 30 Stat. 544), and with certain changes and amplifications remained the basis of priority distribution under the Chandler Act, the Act of June 22, 1938, c. 575, 52 Stat. 840, presently in force.

With respect to the wage priority provision contained in Section 64a (2) of the present Act, the legislative history shows that Congress first acted in this respect in the Act of August 18, 1941, c. 9, 5 Stat. 440.[7] Section 5 of that Act established three classes of prior claims, the third of which provided that:

> * * * any person who shall have performed any labor as an operative in the service of any bankrupt shall be entitled to receive the full amount of the wages due to him for such labor, not exceeding twenty-five dollars; *Provided,* That such labor shall have been performed within six months next before the bankruptcy of his employer; * * *

Section 28 of the Act of March 2, 1867, *supra,* defined five distinct classes of claims entitled to priority.[8] Granted fourth priority were—

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[7] The first Bankruptcy Act, the Act of April 4, 1800, c. 19, 2 Stat. 19 (repealed by Act of December 19, 1803, c. 6, 2 Stat. 248) contained no wage priority provision.

[8] It is noted that Section 27 of that Act contained an apparently inconsistent priority provision; it provided that on the distribution of the bankrupt's estate all creditors whose debts were duly proved and allowed should be entitled to share in the bankrupt's estate *pro rata,* without any priority or preference whatever, except that debts for wages (as described in Section 28) "shall be entitled to priority, and shall be first paid in full * * *".

> wages due to any operative, clerk, or house servant, to an amount not exceeding fifty dollars, for labor performed within six months next preceding the first publication of the notice of proceedings in bankruptcy.

The priority provision of Section 64 of the Bankruptcy Act arranged classes of claims in two groups. Subdivision (a) granted a first priority to all taxes—national, state and local. All other debts accorded priority were grouped in subdivision (b), which, after providing for the payment of various costs and expenses of administration, accorded specific priority to—

> wages due to workmen, clerks, or servants which have been earned within three months before the date of commencement of proceedings, not to exceed three hundred dollars to each claimant * * *.

This wage priority provision of the Bankruptcy Act of 1898 was subsequently amended by the Act of June 15, 1906, c. 3333, 34 Stat. 267, which added "traveling or city salesmen" to the types of wage claimants entitled to priority of payment, and by Section 15 of the Act of May 27, 1926, c. 406, 44 Stat. 662, which increased the maximum amount of the wage claim from $300 to $600.

Section 64a as amended by the 1938 Act restated the wage claim, as previously in effect, but improved its relative position by according it second priority as against a fourth priority for federal and local taxes, and broadened the language thereof so as to cover traveling or city salesmen "on salary or commission basis, whole or part time, whether or not selling ex-

clusively for the bankrupt". A recent amendment effected by the Act of July 30, 1956, c. 784, 70 Stat. 725, Section 1, provided that, for purposes of Section 64a (2), the term "traveling or city salesmen" included "all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract".*

Thus, Section 64a (2) of the Bankruptcy Act uses language which dates back to 1841. That language, so far as pertinent here, accords priority to "debts" in a sequence which subordinates Federal and State tax claims to "wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the [bankruptcy] proceeding, due to workmen * * *."

In holding that the unpaid welfare fund contributions of the bankrupt, Embassy Restaurant, Inc., are entitled to priority over the Federal Government's claim for unpaid taxes of the bankrupt, the court below based its decision in large part upon its conclusions (R. 45) that "unions bargain for these contributions as though they were wages," that "industry considers the contributions as an integral part of the wage package," and that they must be "considered wages." But the Court cannot be concerned here with the question of how far the word "wages" may be stretched as an abstract proposition or in other contexts. We are here dealing with a statute which specifies the relative priority of claims of classes of

* This amendment was effective only with respect to proceedings commenced on or after July 30, 1956.

creditors. As this Court stated in *Nathanson* v. *Labor Board,* 344 U. S. 25, 28–29:

> The contest is no longer between employees and management but between various classes of creditors. * * * [I]f one claimant is to be preferred over others, the purpose should be clear from the statute. * * *

A purpose to prefer claims for unpaid welfare fund contributions over a federal tax claim is *not* clear. The evidence points the other way.

In the first place, the language of the statute, read in light of the fact that the priority accorded to "wages" dates back to 1841, indicates that Congress used the word "wages" in "its lay and colloquial meaning."[10] Moreover, since welfare funds are of comparatively recent origin, it is also a necessary conclusion that Congress did not legislate with the idea that the word "wages" would cover unpaid contributions to union welfare funds. Indeed, even under more recent legislation in certain other areas, such employer contributions are not treated as wages; under the Internal Revenue Code of 1954, Sections 106 and 3121 (a) (2), they are not taxable income to the employees and are not a part of the employees' base pay for the purpose of computing social security taxes. Under these circumstances, welfare fund contributions certainly cannot be considered "wages" for the purposes of this priority statute unless they are

[10] *In the Matter of Sleep Products, Inc., Bankrupt,* 141 F. Supp. 463, 467–468 (S. D. N. Y.), affirmed *sub. nom. Local 140 Security Fund* v. *Hack,* 242 F. 2d 375 (C. A. 2d), certiorari denied, 355 U. S. 833.

a type of debt claim whose priority would fulfill the Congressional purpose in granting the priority to wages. In our view, they do not fulfill that purpose.[11]

While, with one exception,[12] the reports of the Congressional committees pertaining to the above-mentioned Acts (pp. 11–13) do not state the purpose of the priority provision, that purpose is fairly apparent. Having presumably used the word "wages" in its old and ordinary sense, Congress must have granted the priority to "wages" as a cushion or protection to wage earners in mitigation of the financial hardship caused by sudden unemployment by reason of their employer's bankruptcy. And that is the purpose which the courts have consistently attributed to Congress. Thus, it has been stated that Section 64a (2) was enacted by Congress "in order that workmen or servants, persons of menial position and low income, should receive a priority in bankruptcy due to the fact that they, as a class, could ill afford to be classified as general

[11] Welfare fund contributions are of course quite different from such items of compensation as vacation pay, severance pay, and back pay under the National Labor Relations Act, which have been held to be embraced by the word "wages" as used in Section 64a (2). See cases cited in footnotes 22, 23, and 24, *infra*, p. 26.

[12] The House Report pertaining to the Act of June 15, 1906, *supra*, which added "traveling or city salesmen" to the types of claimants entitled to wage priority, gave as the reason therefor that the federal courts had decided that the original act was not broad enough to include traveling salesmen in the list of those employed by the bankrupt to whom a preference was given, and that traveling salesmen, being away from home a great portion of the time, did not have the opportunity of protecting themselves as did other employees of the bankrupt. H. Rep. 2753, 59th Cong., 1st Sess.

creditors";[13] that it was the purpose of Congress to protect the wages of laborers due them by insolvents since the "laborer is generally dependent upon his wages for livelihood and the support of his family" and since every consideration of morality, as well as public policy, demands that his wages be preserved to him and be given priority "over ordinary commercial claims";[14] that the obvious purpose of according priority to wage claimants was to protect persons dependent upon their wages for livelihood since they can not be expected to know the credit standing of their employer and must accept employment as it comes;[15] that priority of payment was intended "for the benefit only of those who are dependent upon their wages" and who, having lost their employment by the bankruptcy, would be in need of such protection;[16] and that the "intention of Congress was plainly to give special protection to a class of wage-earners who generally have no substantial savings or other reserves to fall back on in case of adversity and therefore cannot afford to lose."[17] In general, therefore, the legislative intent underlying the priority given to

[13] *In re Paradise Catering Corp.*, 36 F. Supp. 974, 975 (S. D. N. Y.), holding that an actress who was a star and principal in a show was not a "workman" or "servant".

[14] *Manly* v. *Hood*, 37 F. 2d 212, 213–214 (C. A. 4th).

[15] *In re Inland Waterways Inc.*, 71 F. Supp. 134 (D. Minn.); *In re Lawson Electric Co.*, 300 Fed. 736 (S. D. N. Y.).

[16] *Blessing* v. *Blanchard*, 223 Fed. 35, 37 (C. A. 9th), holding that a general manager of a business did not require such special protection.

[17] *In re Estey*, 6 F. Supp. 570 (S. D. N. Y.), holding that a teacher was a professional worker, and not a workman, clerk, salesman, or servant.

certain types of wage claims "is to furnish workers in the lower economic echelons with a protective cushion against the shock of their employers' bankruptcy."[18] As the District Court pointed out in *In the Matter of Sleep Products, Inc., Bankrupt*, 141 F. Supp. 463, 467 (S. D. N. Y.), affirmed *sub nom. Local 140 Security Fund* v. *Hack*, 242 F. 2d 375 (C. A. 2d), certiorari denied, 355 U. S. 833, rehearing denied, October 13, 1958, the reasoning underlying the legislative purpose was (1) that subordinate working men and menial servants depend for their subsistence upon their uninterrupted daily or weekly earnings; (2) that they have inadequate reserves to fall back upon when they are discharged by their employer's business failure and while they are seeking new employment; and (3) that their original choice of employment was relatively limited in scope and, therefore, it would be unrealistic and unfair to make them bear the full credit risk of their employer's bankruptcy.

It follows that the priority accorded to "wages" was granted for a purpose which welfare fund contributions do *not* fulfill—to provide direct financial assistance to employees forced out of work by their employers' bankruptcy. The considerations of public policy and legislative purpose which are inherent in

[18] *In re Victory Apparel Manufacturing Corp.*, 154 F. Supp. 819, 822 (D. N. J.) (now pending on appeal to the Third Circuit); *In re Brassel*, 135 F. Supp. 827, 829 (N. D. N. Y.); *In the Matter of Sleep Products, Inc., Bankrupt*, 141 F. Supp. 463, 467 (S. D. N. Y.), affirmed *sub nom. Local 140 Security Fund* v. *Hack*, 242 F. 2d 375 (C. A. 2d), certiorari denied, 355 U. S. 833.

the priority statute do not encompass an employer's unpaid contributions to a union welfare fund, as the District Court pointed out in *In the Matter of Sleep Products, Inc., Bankrupt, supra.* See, also, *In re Victory Apparel Manufacturing Corp.*, 154 F. Supp. 819 (D. N. J.).

The unpaid welfare fund contributions involved in the present case do not represent direct financial benefits to employees; they are payable to the trustees of the welfare fund, not to the employees. The individual employee's interest is that contributions to the fund become a source of possible welfare benefits, such as insurance, sick, hospital and surgical benefits, for which the employee might become eligible according to the conditions formulated and established by the trustees of the welfare funds. (R. 13, 21–22, 30.) The welfare fund contributions, if given priority, would not result in any *assured* benefit to employees, even indirectly, upon the bankruptcy of the employer. Whether or not a particular employee receives anything from the welfare fund upon the bankruptcy of the employer is speculative and depends upon conditions which have no relation to the bankruptcy of the employer. Even assuming that some indirect benefit or benefits might accrue to the employees shortly after the employer's bankruptcy, it can hardly be assumed that the welfare fund would be so depleted at the time of the bankruptcy that priority of unpaid contributions of the employer is necessary in order to assure such indirect benefits.

B. IT MAY BE PROPERLY ASSUMED THAT CONGRESS WOULD HAVE SPECIFICALLY PROVIDED FOR THE PRIORITY OF UNPAID WELFARE FUND CONTRIBUTIONS IF IT HAD INTENDED SUCH CONTRIBUTIONS TO HAVE PRIORITY

Although the priority statute has been amended several times over the years, Congress has not acted with relation to unpaid welfare fund contributions. It may be assumed that it would have done so had it intended such contributions to have priority. In this connection, it is suggestive that Congress, at one time, passed legislation granting preferred status to workmen's compensation claims.

By Section 4 (a) and (b) of the Act of June 7, 1934, c. 424, 48 Stat. 911, 924, which amended Section 63 (a) of the Bankruptcy Act, Congress specifically established and allowed a priority for workmen's compensation claims. The amendment effected by Section 4 (a) provided (clause (6)) that claims founded upon an award of an industrial accident commission of a state under workmen's compensation laws were provable claims in bankruptcy. Section 4 (b) provided that such claims "shall have the priority provided for in clause (7) of section 64 (b) of such Act of July 1, 1898, as amended". Section 64 (b), as amended by Section 15 of the Act of May 27, 1926, *supra,* in clause (7) accorded priority to "debts owing to any person who by the laws of the States or the United States is entitled to priority". Although the provision allowing proof of industrial accident commission awards was retained in Section 63 (a) as amended by the 1938 (Chandler) Act, the priority previously accorded was omitted.

Since industrial accident awards are somewhat similar in nature to union welfare benefits, the fact that Congress at one time specifically legislated a priority in bankruptcy proceedings for the former, and thereafter saw fit to omit that priority, is persuasive that Congress has been disposed to allow preference to workmen only in relation to claims which are strictly for back pay. As the Second Circuit has stated, where Congress intended that allowances should be made it has carefully enumerated them, and any omissions must be construed as express exclusions. *Guerin* v. *Weil, Gotshal & Manges,* 205 F. 2d 302, 304 (C. A. 2d); *In re Friedman,* 232 F. 2d 151, 152 (C. A. 2d), certiorari denied *sub nom. Klein* v. *Brandt & Brandt Printers, Inc.,* 352 U. S. 835.

Congress could, of course, broaden the categories of priorities so as to include other types of claims by employees or employee organizations. It could give to claims by union welfare funds a preferred status, just as it accorded such status at one time to employees' workmen's compensation claims. Such a proposal, indeed, was recently before Congress in the form of a proposed amendment to the Bankruptcy Act. The bill was not acted upon. Moreover, it is noteworthy that, had it been enacted, it would not have been broad enough to cover the particular claims made by the union welfare funds in the instant case.[19]

[19] The bill, H. R. 8805, 85th Cong., 1st Sess., provided for amending Section 64a (2) of the Bankruptcy Act to add the following:

> and, further, for the purpose of establishing priority under this clause and for computation of the maximum claim to which priority can be given, payments due to any fund or

Congress is not alone in treating "wages" in a priority statute as not including fringe benefits. Under the Bankruptcy Laws of England, equal priority is accorded, by separate provisions, to "wages or salary of any clerk or servant" and to "wages of any labourer or workman" due for services rendered to the bankrupt during the four months preceding bankruptcy, but not exceeding £200.[20] Nevertheless, *another* provision accords priority to insurance contributions, *i. e.*, all amounts due in respect of contributions payable during the twelve months before the date of bankruptcy by the bankrupt as the employer of any person for industrial injuries insurance or for national insurance. The priority accorded to those insurance contributions was established by the

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plan established for the purpose of providing employee benefits, *which are based upon hours worked or wages paid*, shall, *if such payments would qualify as deductible from the employer's gross income under the provisions of the Internal Revenue Code*, be deemed to be wages assigned to the fund or plan by the individual employees upon whose service or wages such payments are based. [Italics supplied.]

Such a bill, if passed, would not accord priority to the type of unpaid welfare fund contributions involved in the present case, if for no other reason than that the contributions here are not "based upon hours worked or wages paid."

[20] The law of bankruptcy in force in England was enacted by the Bankruptcy Act of 1914 (4 and 5 Geo. 5 c. 59) and the Bankruptcy Act of 1926 (16 and 17 Geo. 5 c. 7), which together form a substantially complete code. However, those Acts have been amended by other acts, some of which have added to the priorities established in Section 33 of the 1914 Act with respect to the distribution of the property of a bankrupt. 2 Halsbury's Laws of England (3d ed.), Sec. 464, p. 251. The preferred debts are set forth in 2 Halsbury's Laws of England, *supra*, Sec. 963, pp. 486–489.

National Insurance (Industrial Injuries) Act, 1946 (9 and 10 Geo. 6 c. 62), S. 71 (2), and the National Insurance Act, 1946 (9 and 10 Geo. 6 c. 67), S. 55 (2). The purpose of the former Act, as described in its heading, was to substitute for certain Workmen's Compensation Acts

> a system of insurance against personal injury caused by accident arising out of and in the course of a person's employment and against prescribed diseases and injuries due to the nature of a person's employment, and for purposes connected therewith.

The purpose of the latter Act is described as follows:

> [T]o establish an extended system of national insurance providing pecuniary payments by way of unemployment benefit, sickness benefit, maternity benefit, retirement pension, widows' benefit, guardian's allowance and death grant, to repeal or amend the existing enactments relating to unemployment insurance, national health insurance, widows', orphans' and old age contributory pensions and non-contributory old age pensions, to provide for the making of payments towards the cost of a national health service, and for purposes connected with the matters aforesaid.

It is apparent, therefore, that although the British Bankruptcy Act provision establishing priority with respect to the "wages of any labourer or workman" is substantially the same as Section 64a (2) of our Bankruptcy Act, it was nevertheless deemed necessary to enact a special provision according priority to

claims similar to those union welfare benefits for which priority is claimed here.

The State of New York has also taken action reflecting an understanding that unpaid welfare fund contributions are not in the classification of "wages", as used in a priority statute. In 1952, New York amended its laws so as to grant a preference, in the administration of the estate of an employer who made a general assignment for the benefit of his creditors, to claims of welfare funds for unpaid sums due from the employer. Thus, the definition of "wages or salaries" contained in Section 22 of the Debtor and Creditor Law, McKinney's Consolidated Laws, c. 12, was amended [21] so as to include "employer contributions to or payments of insurance or welfare benefits" and "employer contributions to pension or annuity funds". Prior to the amendment, it had been held that claims for money due for welfare payments were not preferred claims under the statute, even though the amount thereof was computed by a percentage of wages, since it was not deducted from the employee's wages but was merely a matter of contract between the employer and the union. *Matter of Hollywood Commissary* (*Weintraub*), 195 Misc. 441, 87 N. Y. S. 2d 625; *Matter of Well Bilt Box Spring Corp.* (*Bayer*), 196 Misc. 848, 849, 89 N. Y. S. 2d 768. But see *In re Seaboard Furniture Mfg. Corp.* (*Frey*), 89 N. Y. S. 2d 747.

Apart from the fact that the word "wages" in a priority statute has been widely interpreted as not in-

[21] By Laws of New York, 1952, c. 794, Sec. 1, effective July 1, 1952.

cluding unpaid welfare contributions, it should be noted that there are numerous types of bargaining agreements containing provision for payments to welfare funds. As the Second Circuit observed in *Local 140 Security Fund* v. *Hack*, 242 F. 2d 375, 377, certiorari denied, 355 U. S. 833, rehearing denied, October 13, 1958, to ascribe a broader purpose to the wage priority than is indicated by the language and history of Section 64a (2) would lead to as many judicial opinions as there are different forms of collective bargaining agreements containing such provisions. Accordingly, as that court concluded (p. 379), if employer contributions to union welfare funds are to be given priority as a claim for "wages" under Section 64a (2) of the Bankruptcy Act, "that should be done through the legislative action of the Congress, and not by any judicial mislabeling of such payments as 'wages' ". Such was also the conclusion of the District Courts in *In re Victory Apparel Manufacturing Corp., supra,* pp. 822–823, and in the *Hack* case (under the title *In the Matter of Sleep Products, Inc., Bankrupt,* 141 F. Supp. 463). The reasons for this were well stated by the District Court in the latter case as follows (p. 470):

> If the definition of wage claims within section 64, sub. a (2) is to be expanded, that result should be achieved by the method of Congressional amendment. That technique of law revision would afford the opportunity for full debate by labor unions, credit associations, bankruptcy law experts and others. It would permit Congress to adjust, deliberately, competing economic interests and conflicting social

and public policies. It would avoid uncertainty in a relatively new and expanding field of management-labor relations, where there is no standardization in the form and character of union welfare funds and where there is an absence of state regulation. It would enable Congress to explore the impact of the suggested new definition upon the administration of such other statutes as the Taft-Hartley Act.

C. THE BANKRUPT EMPLOYER'S OBLIGATION FOR UNPAID WELFARE FUND CONTRIBUTIONS IS NOT THE TYPE OF DEBT WHICH THE LANGUAGE OF THE PRIORITY STATUTE CONTEMPLATES

The "debt" which has priority under Section 64a (2) of the Bankruptcy Act, so far as pertinent here, is for "wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the [bankruptcy] proceeding, due to workmen * * * ." To give unpaid welfare fund contributions priority thereunder plainly requires a strained construction of the statute—one which accords priority to *third* parties (the trustees of the welfare fund) to the extent of $600 of the *composite* contributions payable by the employer ($8 a month per employee).

This Court declared in *Shropshire, Woodliff & Co.* v. *Bush*, 204 U. S. 187, 189, that the statutory words "seem to be merely descriptive of the *nature* of the *debt* to which priority is given" (italics supplied). Unpaid welfare fund contributions may, in a very broad sense, be called amounts "due to workmen", as the Court said in another connection in *United States* v. *Carter*, 353 U. S. 210 (discussed *infra*, pp. 31–33), but this priority statute is concerned with debts due *directly*

to employees. As the Third Circuit stated in *In re Ko-Ed Tavern*, 129 F. 2d 806, 809, with respect to the priority of a wage claim under the 1938 Act, "the fundamental criterion is the relationship which the claimant bore to the bankrupt." The Second Circuit similarly held in *Local 140 Security Fund* v. *Hack*, 242 F. 2d 375, 377–378, certiorari denied, 355 U. S. 833, rehearing denied, October 13, 1958, that in order to be entitled to priority under Section 64a (2) a claim must be one which "in its origin" was for wages due to a workman and, if it was never such, "no theory of an indirect conditional benefit to him" can give it priority. In brief, the debt must arise from a master-servant or employer-employee relationship, rather than from a relationship of debtor and creditor as between the employer and a third party or parties.

While the language of the priority statute may be satisfied when the employee's claim relates to items of compensation such as vacation pay,[22] severance pay,[23] and back-pay awards under the National Labor Relations Act,[24] it is not satisfied where the claim is for unpaid welfare fund contributions. The relationship here is one of debtor and creditor between the employer and third parties (the trustees of the welfare

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[22] *Division of Labor Law Enforcement* v. *Sampsell*, 172 F. 2d 400 (C. A. 9th); *United States* v. *Munro-Van Helms Co.*, 243 F. 2d 10 (C. A. 5th); *In re Public Ledger*, 161 F. 2d 762 (C. A. 3d); *In re Wil-Low Cafeterias*, 111 F. 2d 429 (C. A. 2d).

[23] *McCloskey* v. *Division of Labor, Etc.*, 200 F. 2d 402 (C. A. 9th).

[24] *Nathanson* v. *Labor Board*, 344 U. S. 25; *National Labor Relations Board* v. *Killoren*, 122 F. 2d 609 (C. A. 8th), certiorari denied, 314 U. S. 696; *Kavanas* v. *Mead*, 171 F. 2d 195 (C. A. 4th).

fund). The employees were never entitled to enforce the employer's obligation and they never had any right, title or interest in the welfare fund other than in relation to their eligibility for such welfare benefits as might be established. (R. 21–22.) The unpaid employer contributions to the welfare fund are nothing more than ordinary commercial claims due to independent entities, albeit designed for use for employee welfare purposes. This is far removed from the type of employer-employee debt contemplated by the priority statute.

The language of the statute cannot be stretched on the theory that a bankruptcy court is a court of equity. The exercise of its equitable powers must be strictly confined within the prescribed limits of the Bankruptcy Act. *Young* v. *Higbee,* 324 U. S. 204, 214. The right to priority of payment, therefore, results from the Act and cannot be enlarged by contract or extended under general equitable principles. *United States* v. *Munro-Van Helms Co.,* 243 F. 2d 10, 12 (C. A. 5th); *In re Newark Shoe Stores,* 3 F. Supp. 293 (D. Md.); *Southern Bell Telephone & Telegraph Co.* v. *Caldwell,* 67 F. 2d 802 (C. A. 8th). Any right to priority must be found in the language of the statute. *In re Wilkes-Barre & E. R. Co.,* 46 F. Supp. 12 (M. D. Pa.).

D. THE SECOND CIRCUIT'S VIEW SHOULD BE FOLLOWED

The precise question presented in this case was the subject of decision by the Second Circuit in *Local 140 Security Fund* v. *Hack, supra,* and by several District Courts. Except for the decisions in the present case and the clearly distinguishable decisions in *In re Otto,*

146 F. Supp. 786 (S. D. Cal.) and *In re Ross*, 117 F. Supp. 346 (N. D. Cal.),[25] those courts which have passed on the question have held that employer contributions to union welfare plans are not "wages * * * due to workmen" under Section 64a (2). *In the Matter of Sleep Products, Inc., Bankrupt, supra; In re Brassel*, 135 F. Supp. 827 (N. D. N. Y.); *In re Victory Apparel Manufacturing Corp., supra.*

The *Local 140 Security Fund* case involved payments, computed upon the basis of the gross payroll of the employees in a union bargaining unit, which the employer was required to make to a union welfare fund whose welfare purposes[26] were similar to those

[25] In *In re Otto*, *supra*, the employer contribution to a union welfare fund came from *setting aside* for such purpose (146 F. Supp. at 788) "specified portions (originally five cents and later six cents per hour) of cost-of-living wage increases" obtained after collective bargaining following annual wage reopenings. The basic fact warranting priority of such a claim under Section 64a (2) lay in the fact that "in its origin" it was one for wages due to workmen. This is also true with respect to the case of *In re Ross*, *supra*, where employees who entered into a voluntary plan of disability insurance consented to wage *deductions* for the payment of disability insurance premiums. As the court there stated (117 F. Supp. at 348) "The debt of the bankrupt was incurred for services which they rendered, and not for insurance benefits". In both the *Otto* and *Ross* cases the decisions also rested in part on the fact that under California law there could be a valid assignment of wages to the welfare funds. Both cases are distinguishable on their facts from the instant case, where the claim did not originate as one for wages due to workmen but rather constituted an ordinary commercial claim arising from a debtor-creditor relationship. Cf. *McKee* v. *Paradise*, 299 U. S. 119; *In re Flick*, 105 Fed. 503 (S. D. Ohio).

[26] The opinion of the District Court therein recites (141 F. Supp. 463, 465) that, under the terms of the trust agreement under which that Fund was organized, the Fund undertook

here involved. As appears from the District Court's opinion (141 F. Supp. 463, 465), under the express terms of the trust agreements setting up the claimant fund "neither the employer nor the individual employee have [sic] any right, title or interest in or to any part of the trust estate or fund so created, except such rights as might accrue to an employee under an insurance policy or for other welfare benefits." The Second Circuit held that (242 F. 2d at 378) the required payments did not constitute "wages * * * due to workmen" within the priority provision of Section 64a (2),[27] but, rather, that they "created only a debtor and creditor obligation between the employer and third parties, for something other than wages." "The language of the statute," it concluded, "cannot be stretched so as to embrace this type of claim".

In the *Brassel* and *Victory Apparel* cases, *supra,* the agreements providing for employer contributions to union welfare funds were also similar to those in the instant case, except that in those cases the contributions were based upon percentages of wages paid the employees. The agreement in the *Brassel* case provided that the employee had no right, title or interest in any part of the trust estate except such rights as might accrue to him under an insurance

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to finance various types of social insurance for employees in the bedding industry, including but not limited to life insurance, accident and health insurance, insurance for medical care and hospitalization, and disability benefit insurance.

[27] In a concurring opinion, Judge Hincks stressed that the statutory priority could not be accorded to the Fund because it was "self-evident" that the Fund was not a *workman* within the meaning of the Act 242 F. 2d at 378.

policy or other welfare benefits; that no employee had any option to receive any part of the employer's contribution in lieu of the benefits provided by the trustees;[28] and that such rights were not assignable. In addition to provisions similar to the last two noted above, the trust agreement in the *Victory Apparel* case provided that neither the employer nor any member of his family had any right to receive any cash consideration in lieu of the benefits provided, either upon the termination of the trust or through severance of employment or otherwise. In the latter case, the District Court of New Jersey subscribed to the reasoning and conclusion reached by the Second Circuit in the *Local 140 Security Fund* case, *supra*. In the *Brassel* case, the court, in denying the priority claims asserted by the trustees of the welfare fund, concluded (p. 830) that even the most liberal construction "of the term 'wages' does not justify a nullification of the language of the statute which grants priority only to 'wages * * * due to workmen'"; that, since the employer's contribution was never due to the employee, the employee could not enforce the employer's liability therefor; and that the employee never had an individual or assignable proprietary

[28] The contributions were to be used to provide and pay for premiums upon policies of accident, health and group life insurance or for direct payment of medical and hospitalization expenses of members of the union and whether or not covered by collective bargaining agreements between employers and the union (pp. 828–829).

interest in the contribution or the fund of which it became a part.[29]

The reasoning of the courts in the above-mentioned cases is equally applicable under the facts of this case. Here, the trust agreement expressly provided (R. 21–22) that the monies paid into the Plan "shall not constitute or be deemed monies due to the individual Employees"; that title thereto vested exclusively in the trustees; that neither the employee nor any person claiming by or through an employee had any right, title or interest in the Welfare Plan or any part thereof; and that the trustees were the persons empowered to enforce payment of the employer contributions. The trustees had absolute discretion in the administration of the Welfare Plan, and were not liable for the proper application of any part thereof, in the absence of wilful misconduct, bad faith, or gross negligence. (R. 18.) It does not appear that the individual employees or their families had any right to receive cash or other direct benefits. To grant priority status in these circumstances would be to "redesign the statutory pattern" of Section 64a (2). *In the Matter of Sleep Products, Inc., Bankrupt, supra,* p. 469.

E. THIS COURT'S *CARTER* DECISION DOES NOT SUPPORT THE HOLDING OF THE COURT BELOW

The question in *United States* v. *Carter,* 353 U. S. 210, was the extent of a surety's liability under a Miller Act payment bond. The Miller Act, c. 642, 49

[29] The decision in the *Brassel* case, was the subject of a favorable comment in a note in 34 Chicago-Kent L. Rev. 235 (1956) and of a critical comment in 19 Ga. Bar J. 107 (1956).

Stat. 793, provides that before any contract exceeding $2,000 for the construction of any public work of the United States is awarded to any person, such person shall furnish to the United States a payment bond with a satisfactory surety. The Act grants to every person who has furnished labor or material in the prosecution of the contract work, and who had not been paid in full therefor, the right to sue on such payment bond "for the sum or sums justly due him." In *Carter*, a government contractor had defaulted on his obligation to contribute to a construction workers' health and welfare fund established under a collective bargaining agreement. The purpose and nature of the fund, the powers of the trustees, and the rights of the employees were substantially the same as they are in the present case. This Court's holding sustained the right of the fund's trustees to collect from the surety for the contractor's default in contributions.

It is to be emphasized that the decision does not reflect a holding that the contributions were part of the construction workers' "wages." Indeed, as this Court stated (p. 214), the trust agreement expressly provided that the contributions "shall not constitute or be deemed to be wages." The Court did not find this a crucial consideration because, as it observed (p. 217), the Miller Act "does not limit recovery on the statutory bond to 'wages'." The statute, having broad protective purposes, grants a right to recover all sums "justly due." "For purposes of the Miller Act," the Court concludes (p. 220), the contributions, having been bargained for, "are in substance as much 'justly due' to the employees who have earned them as are

the wages payable directly to them in cash." In other words, the contributions, though not wages, are "justly due" and within the scope of the Miller Act.

Carter thus furnishes no support for concluding either (a) that such contributions are "wages" or (b) that all sums which are "justly due" employees or their representatives are entitled to priority in bankruptcy.

It is apparent, in our view (see *supra,* pp. 9–18), that Congress had a limited purpose in according wages due workmen a priority over other amounts due to persons claiming against the bankrupt: granting to workmen a priority for their back pay would serve as a cushion against the hardship which might result from the need to secure another job. This does not justify the conclusion that Congress has granted to all claims by or on behalf of employees priority over all claims justly made by all other claimants. Priorities may be allowed by the bankruptcy court only to the extent clearly provided by the legislature.

The court below has implied, though, as we see it, without any justification in the legislative background or history, that the wage priority provision of Section 64 has a most comprehensive purpose.[30] It relates

[30] Cf. *In re Otto*, *supra*, p. 789, where the court was persuaded by the circumstance that, in the absence of specific exception, employers' health and welfare contributions have been held to constitute wages within the meaning of the Labor Relations Act, as amended by the Labor Management Relations Act of 1947 (*Inland Steel Co.* v. *National Labor Relations Board*, 170 F. 2d 247 (C. A. 7th), certiorari denied, 336 U. S. 960; the Social Security Act (*MacPherson* v. *Ewing*, 107 F. Supp. 666 (N. D. Cal.); and the Federal Employment Tax Act (*City of Avalon*, 156 F. 2d 500 (C. A. 9th). That

Section 64a (2) to what it describes (R. 42) as "the ultimate aspiration of the American labor movement," namely, the "achievement of complete economic security for industrial workers." This appears from its statements (*ibid.*) that "One method of attaining a measure of this security is the union welfare fund maintained to provide employees with life insurance, hospital and surgical benefits, sick pay, and other advantages"; that under virtually all arrangements for a welfare fund the collective bargaining agreement obligates the employer to contribute a certain sum of money periodically to the fund; and that these union funds "play an essential and ever growing part in our industrial economy" (R. 45). This broad view of the objectives of the labor movement may well be sound and the objectives may well be worthy. If Congress should be of the view that it should seek to promote through the bankruptcy laws maximum security for industrial workers, it might, perhaps, at some future date, choose to lift the present $600 ceiling on priority claims for wages due workmen. But that would be a judgment for Congress to make. Similarly, we think, it is for Congress to decide whether the concept of wages due to workmen—a

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court also "buttressed" its decision by adverting to the fact that such contributions were specifically excepted from an employee's gross income by Section 106 of the Internal Revenue Code of 1954, and are not deemed a part of an employee's base pay for the purpose of computing social security taxes under Section 3121 (a) (2) of that Code. Cf. the *Sleep Products* case, *supra*, where the court thought, as we do (*supra*, p. 14), that these latter two considerations supported its conclusion that such contributions were *not* "wages" under Section 64a (2) of the Bankruptcy Act.

concept which had its genesis in provisions more than one hundred years old—is now to be extended so as to take in contributions which are not, properly speaking, wages and which are not made to workmen but to union welfare fund trustees.[31] A proposal to do this has been before Congress and will doubtless be made again. If a change is to be made, however, it should be made, we believe, by means of legislation.

CONCLUSION

The judgment of the court below should be reversed.

Respectfully submitted,

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[31] Welfare and insurance funds are, of course, of many types. They do not necessarily provide unemployment benefits. Thus, there is no indication that such benefits are provided by the funds here involved. It cannot be assumed, then, that to grant preferred status to all funds would be to serve the object which lies at the root of Section 64a (2), *i. e.*, to tide over the displaced worker. Indeed, in situations where the bankrupt's assets are insufficient to meet all claims for back pay, the tendency would be in the other direction.